



BY JEFFREY E. GARTEN

Europe: Staring Into the Abyss

Since May, the European Union has incorporated 10 new members, presided over Europewide elections for the EU Parliament, agreed on a first-ever EU constitution, and appointed a new president of the European Commission. But no amount of political activity can camouflage Europe's potentially dismal future. And because this region now accounts for a third

of the world's gross domestic product, the problems besetting the EU could have as massive an impact on the world economy as the rise of China.

The EU's economic and social model is broken. It's not just that this past decade has been one of anemic growth and double-digit unemployment for the Continent, nor that projections are for a continuation of the same. More fundamentally, Germany, France, and Italy—which together account for over 60% of activity in the euro area—will be unable to compete with the U.S. on one side and China on the other. They are stuck in a time when it was an asset to have cozy banking relationships, permanent job security, and sky-high government-financed entitlements.

TODAY, EUROPEAN EFFORTS to develop knowledge-based economies with robust research-and-development programs and superior universities are nowhere near enough. Even though there has been some progress in slowing trade union demands, trimming expensive social programs, and liberalizing immigration policies (as occurred in Germany recently), deep-seated changes are much too slow in coming. Meanwhile, the combination of Europe's aging populations, declining birthrates, and rising fiscal deficits make America's challenge of financing Social Security look easy.

It's no wonder that high-tech companies such as Switzerland's Novartis have moved their R&D to the U.S. In mid-July, DaimlerChrysler threatened to cut 6,000 jobs and shift substantial production overseas due to high labor costs.

The biggest problem is the increasingly dysfunctional political environment. This summer has seemed like one long public brawl. Nicolas Sarkozy, France's Finance Minister, criticized the European Central Bank for high interest rates. EU Commissioner Frits Bolkestein attacked French and German government policies to prop up industries, such as pharmaceuticals and banking. The European Commission, the European Council, and the European Court argued over who sets fiscal rules.

In June, appallingly low turnout for elections for the European Parliament showed that voters are apathetic about the EU itself. Shortly afterward, EU leaders further damaged

their credibility by agreeing to a dense 300-page constitution that ordinary citizens could not possibly understand. "The EU has become too complex and too chaotic," said Victor Halberstadt, a professor of economics at the Netherlands' Leiden University and a longtime adviser to government and corporate leaders throughout the Continent. "There are no viable national solutions and no effective supranational structures," he told me in an interview.

Claude Smadja of Smadja & Associates in Geneva, a strategic adviser to companies and government entities around the world, lambastes European politicians. "They are cowards," he told me, "because they have not leveled with European citizens about how dire their circumstances are. Europeans have been deluded into thinking that incremental policy changes will work."

Soon, the EU may be unable to compete. Meanwhile, pols bicker

The upshot? We could well see a gradual increase in European protectionism as the EU fails to become globally competitive. European governments could force the European Central Bank into dangerously loose monetary policies. Politicians on the extreme right could become more attractive to highly frustrated citizens.

Europe's capability to fight global poverty or finance antiterrorist activities could diminish.

Europe needs a Margaret Thatcher-type revolution, says Smadja. But given the political and cultural differences, no one national leader could have the influence on all of the EU that the Iron Lady had on Britain, says Leiden University's Halberstadt. "There is arising in Europe a sense of helplessness and hopelessness," he told me.

European integration was propelled by a vision of preventing European nations from ever again going to war with one another. Now a compelling new rationale for a true European union is necessary. Sadly, none is in sight. ■

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